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Perspectives for the Development of European Secured Notes

Abstract

The idea of creating a new capital market instrument emerged from the concept of Capital Markets Union. It draws inspiration primarily from the very good experience of covered bonds, which provide a stable, long-term and relatively cheap source of financing banking activities, while contributing to building the stability of the financial system. European Secured Notes fulfill the aims of the Capital Markets Union by supporting the financing of small and medium enterprises, which are the backbone of the EU economy, and which have been particularly hard hit by the COVID-19 crisis. The identification of the requirements for the development of ESNs, presented in this article, fits with the needs of the recovery of the post-pandemic European economy.

Key words: European Secured Notes, covered bonds, small and medium enterprises, financing economic recovery, ESG financing, Capital Markets Union

JEL codes: G18, G28

Perspektywy rozwoju europejskich obligacji zabezpieczonych

Streszczenie

Pomysł stworzenia nowego instrumentu rynku kapitałowego narodził się z idei unii rynków kapitałowych. Czerpie on inspirację przede wszystkim, z bardzo dobrego doświadczenia listów zastawnych, które zapewniają stabilne, długoterminowe i stosunkowo tanie źródło finansowania działalności bankowej, przyczyniając się jednocześnie do budowania stabilności systemu finansowego. Europejskie obligacje zabezpieczone realizują cele unii rynków kapitałowych wspierając finansowanie małych i średnich przedsiębiorstw, stanowiących trzon unijnej gospodarki a które zostały szczególnie dotknięte kryzysem wywołanym COVID-19.

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Identyfikacja przesłanek rozwoju ESNs, które zostały przedstawione zostały w niniejszym artykule, wpisuje się w potrzebę odbudowy post-pandemicznej gospodarki europejskiej.

Słowa kluczowe: europejskie obligacje zabezpieczone, listy zastawne, małe i średnie przedsiębiorstwa, finansowanie odbudowy gospodarki, zrównoważone finansowanie, unia rynków kapitałowych

Introduction

The idea of European Secured Notes (ESNs), which, similarly to covered bonds for mortgage loans, allow long-term source of financing banking activities in the small and medium enterprises (SME) lending segment, was born in the context of a debate of the Capital Markets Union (CMU)[1].

ESNs draw on the success of covered bonds, use best market practices for financing banking activities and address the needs of institutional investors. The idea of a new financial product is for it to remain available in stressful situations, work countercyclically and ensure the continuity of supply of sustainable private financing of the real economy, just like covered bonds, which exercise this role very well (Grossmann, Stöcker 2015, p. 110–111).

The idea of a new equity instrument has gained importance as a result of the EC initiative of the European Commission's new CMU Action Plan (*Capital markets union 2020 action plan...* 2020) and in view of the possibility of using ESNs to recover the post-crisis economy. The crisis caused by the COVID-19 pandemic, which has affected in particular the SME segment, which is the backbone of the European economy, requires comprehensive and coordinated actions.

The purpose of this Article is an attempt to identify the prospects for the development of European Secured Notes as a new instrument of the capital market and the role they can play in the recovery of the European economy following the crisis caused by the COVID-19 pandemic.

[1] The Capital Markets Union project aims to facilitate the inflow of investments from other countries and the movement and transfer of capital mainly to small and medium enterprises within the EU, among many, by the reinforcement of financing by capital markets compared to classical bank financing. European Parliament resolution of 9 July 2015 *on the creation of a capital markets union*, 2015/2634 (RSP) (*Capital Markets Union...* 2015).

1. EBA Recommendations

The EC requested the EBA to prepare recommendations on the ESNs standard, which were published in June 2018 (*EBA Report on European Secured Notes* (ESNS) 2018). These recommendations largely derive from the success of the harmonized European Covered Bond Framework (Directive (EU) 2019/2162).

1.1. Product standardization

According to the EBA recommendations, ESNs should be dual-recourse instruments so that investors have a primary claim to the credit portfolio constituting the cover pool and a direct claim to the bank issuing or guaranteeing ESNs, as is the case with the covered bonds.

The main differences between SME loans, on which ESNs are secured, and mortgage loans, on which the bonds are secured, are as follows (Vogel et al. 2020, p. 4):

- SME loans have higher claims ratios and are less homogeneous than mortgage loans;
- data on credit quality of SME loans are not standardized, which makes it difficult for lenders and investors to precisely determine and compare the quality of these loans;
- SME loans are usually unsecured, so lenders are usually unable to use LTV ratio to estimate the risk of these assets, as opposed to mortgage loans.

The EBA provided detailed recommendations on the ESNs product standard and how the model of the covered bonds should be adapted to the characteristics of SME loans in order to limit the risks identified above:

- each borrower under the cover pool should be an undertaking with an annual turnover not exceeding EUR 50 million[2];
- only registered EU credit institutions may issue ESNs[3];

[2] In view of the differences in the definition of SME between EU Member States, the EBA recommended adopting a common definition to harmonize the framework of SME ESNs and proposed using the definition in Article 501(2) *Capital Requirement Regulation* (CRR), which is widely used within EU institutions. In addition, the advantage of the CRR definition is that it covers a bigger number of SME loans than other definitions and its use would allow SME ESNs to qualify for preferential prudential treatment in the scope of use of capital (Regulation (EU) No 575/2013**)**.

[3] This requirement aims to ensure that ESNs will be eligible for preferential treatment under the *Undertakings for the Collective Investment of Transferable Securities Directive* (UCITS), which allows for a freedom of operation of joint financing schemes within the EU under the authorization of a given Member State. Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 *on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions*, which amended Directive 2009/65/EC (*Undertakings for the collective investment in transferable securities, UCITS*).

- ESNs should be bankruptcy-remote instruments and investors should have dual recourse to the bank and to the cover pool[4];
- the cover pool should:
  - be separated[5] and unencumbered by claims of third parties;
  - include assets located in the European Economic Area (EEA)[6];
  - be exposed to a minimum of 500 borrowers;
  - have a minimum over-collateralisation of 130% of the capital plus interest[7];
  - be limited to regularly serviced SME loans and lease exposures within a single asset class[8];
  - be dynamically, periodically adjusted in accordance with the above criteria during the lifetime of the ESN[9];

4 ESNs should have two important characteristics protecting them from bankruptcy, such as the covered bonds: (i) they should not be subject to automatic acceleration of debt repayment and investors should be provided with a preferential claim to the SME cover pool and (ii) the issuer should implement operational procedures in order to ensure a smooth transfer of responsibilities to the administrator in the event of insolvency.

5 Separation may be achieved by actual sale/pledge or use of the provisions of Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements (*the Collateral Directive*). By comparison, the European Covered Bond Framework allows for segregation through (i) the cover register, which is a repository of all mortgage loans that are charged under a given cover pool (ii) transfer to a special purpose vehicle (SPV) through an actual sale or a contractual assignment, or (iii) segregation to a specialized credit institution (e.g. a specialized mortgage institution) at the time when the segregation is binding and required, including as a result of bankruptcy or restructuring of the issuer. Potentially one or more premises may be adopted for SME ESNs (Directive 2002/47/EC).

6 The assets of the cover pool should be limited to the EEA so that, in the event of non-compliance of the contract by the issuer, a liquidation of the coverage is legally enforceable. Although the EBA report does not specify this, it can be assumed that the location of assets and the registered office of the borrower should be located in the jurisdiction of the EEA. The European Framework of Covered Bonds includes an equivalence identification mechanism for certain jurisdictions that allow international emissions including the cover pool in which mortgages from outside the EU may occur. The question remains whether a similar mechanism will be applied in ESNs.

7 It is considered that SME ESNs need a higher over-collateralisation than traditional cover bonds, for which the benchmark is set at a minimum level of 105%. This is due to a higher risk of loss that may occur in the SME credit portfolio compared to the portfolio of mortgage. The EBA recommended a minimum requirement of 130% of over-collateralisation as it places itself between the observed over-collateralisation levels for covered bonds less exposed to risk (118%) and asset-backed securitisation (138%), which carries a greater risk.

8 The cover pool of SME ESNs should meet minimum conditions to ensure its high quality. In order not to unduly restrict the market, the recommendations are not excessively detailed in order not to exclude potentially high-quality loans. According to the EBA, the high level of over-collateralisation required for SME ESNs of 130% should cover all the risks that may materialize. In addition to the limited pool of assets, the EBA has set the following requirements: (i) appropriate risk diversification and a sufficiently high granularity of the cover pool should provide a minimum of 500 loans; (ii) the cover pool should be free from significant concentrations, e.g. aggregate exposure to one borrower should not exceed 2% of the total exposure value of the cover pool; (iii) in addition to the regular nature of SME loans, credit institutions should themselves have appropriate and well-defined standards of providing underwriting of issues.

9 A dynamic management of the cover pool addresses a potentially high risk of replenishment of assets that is specific to SME loans. It is highly likely that the cover pool of SME ESNs will have a short life,

- the issuer must establish a liquidity buffer[10].

The recommendations of the EBA place SME ESNs as instruments with defined quality parameters and form the basis for minimum harmonization, although the SME loan and lease exposures are naturally different in other sectors of the economy. Moreover, bankruptcy law and the related restructuring provisions also differ significantly between individual EU countries.

1.2. Infrastructure assets

Although the initial consideration was to stimulate infrastructure financing also through ESNs, the EBA ultimately presented a negative recommendation in this respect. Instead, it proposed to use infrastructure bonds with a single recourse backed by a static pool of assets. According to the EBA, a dual recourse instrument would not be appropriate in this case. An infrastructure loan-backed instrument is preferable because of the specific nature of assets and the heterogeneity of infrastructure loans, which are linked to specific assets with an individual flow generation profile (e.g. motorways or pipelines). These instruments have different risk profiles and grouping such different loans into a single cover pool under the same instrument would lead to a complex credit risk profile. Moreover, according to the EBA, a dual recourse instrument would not be appropriate for infrastructure projects which consume a relatively large amount of regulatory capital due to long term and high funding amounts and the requirement to create reserves. Standardization of infrastructure bonds in the EU will therefore require a new instrument, other than ESNs. The EBA proposed to create standardized EU infrastructure bonds for this purpose.

1.3. Supervision and reporting requirements

The following recommendations were presented in the scope of supervision and reporting of the ESN emissions of the EBA:

- each member state should designate a competent body:
  - allowing ESN emissions;
  - monitoring the compliance of ESN programs;
  - supervising, investigating and imposing sanctioning in the scope of ESN in accordance with the established regulatory framework;

as there is a high probability that the cover pool will be repaid before the maturity of the ESN. It can be expected that a dynamic management of the cover pool will allow for a removal of assets that will no longer meet the eligibility criteria also for other reasons (e.g. failure of the SME to comply with the credit agreement or their acquisition by other/large companies), as is currently the case for covered bonds.

10 A liquidity buffer refers to cash and cash equivalents held in a separate manner that allows for additional coverage of the ESNs.

  - taking appropriate measures in the scope of restructuring and orderly winding up of the issuer, as in the case of the European Framework of Covered Bonds.
- if a competent supervisory authority of a Member State does not directly monitor the cover pool, it should be supervised by a dedicated entity independent of the credit institution and its financial auditor (differently from what is defined by the European Framework of Covered Bonds)[11];
- issuers should perform periodic stress tests of the cover pool to assess the impact of key risk parameters on the collateral and the ability of the ESN programme to process payments of issued instruments fully and in line with the schedule;
- as the cover pool is dynamic, issuers should provide initial and quarterly financial reports to investors, including, among many, information on the number of loans in the cover pool, the exposure value and the initial funding period of each credit, industries in which borrowers operate and the location of assets.

The presented recommendations on reporting are similar to the requirements of the European Framework of Covered Bonds and constitute a lighter version of the information standards compared to typical securitisation instruments (*Securitisation Framework*) (*European Commission Proposes...* 2020). The ESNs dual recourse mechanism ensures that more detailed information is not required. The implementation of the EBA recommendation would enhance the attractiveness of ESNs, they would be easier to administer and banks would not have to obtain permission from borrowers to share information or organize a cumbersome process for the collection of internal data.

1.4. Regulatory treatment

In view of a higher risk profile of SME ESNs, the EBA has assumed that they will have a higher risk weight than the covered bonds, which will affect their regulatory treatment. As regards capital requirements, as opposed to traditional cover bonds, SME ESNs should not enjoy preferential treatment due to the profile of the assets constituting their coverage. SME loans do not have standardized coverage, as in the case of mortgage loans. Differential treatment of risk weights is acceptable for SME ESNs on the assumption of certain conditions mitigating risk. If these conditions were met, ESNs would probably have higher risk weights than covered bonds but lower than unsecured bonds[12]. An investment in instruments that generate lower

[11] The framework of covered bonds was developing for more than two centuries, which has shaped market standards ensuring that the covered bonds are well monitored, without the need for additional supervision. In contrast to the covered bonds, ESNs have no history, on which such solutions may be built and therefore need to be monitored more closely during the initial period of their operation (e.g. Italian OBC have been subject to supervision by the Bank of Italy to ensure an adequate level of control and at the same time to allow for preferential regulatory and prudential treatment).

[12] According to the EBA recommendations, in order for SME ESNs to be eligible for differential treatment in terms of risk weights, they should meet the following criteria: (i) they should have a dual recourse feature and meet the structural and cover asset eligibility criteria to ensure sufficient credit

capital costs and have more liquidity than SME loans alone would lead to a reduction in the financing costs of the SME, just like covered bonds and securitisation allow a reduction in mortgage margins.

EBA recommended that SME ESNs should be eligible for preferential treatment under the UCITS Directive (Directive 2014/91/EU). UCITS establishes maximum investment levels for the investments of funds, acting in the EU on a single European passport, for individual classes of assets. In general, the exposure to bonds is limited to 5%, although UCITS may, under certain conditions, invest up to 25% of assets in eligible covered bonds[13]. EBA recommended that SME ESNs should also obtain more favourable investment limits for UCITS funds. Moreover, as secured claims, governed by dedicated legislation, especially if the recommended framework is approved by the European Parliament, SME ESNs would be exempted from the bail-in[14].

Although the EBA did not take a position whether the regulatory capital treatment of insurance companies investing in ESNs in the context of Solvency II should be changed, it sees the insurance investor base as particularly well suited to the financing of SME loans and suggests that the European Insurance and Occupational Pensions Authority (EIOPA) considered the possibility for insurance companies to give special treatment to these instruments The EBA noted that the proposed treatment of investments in ESNs by credit institutions according to the CRR, between covered bonds and direct emissions of credit institutions, should contribute to a reduction in the spread for risk reduction of insurance companies using the standard model under Solvency II.

enhancement and mitigate many of the risks of the underlying assets; (ii) they should respect the overall coherence of the CRR capital framework between exposures classes and in particular the capital treatment of SME ESNs should be based on the actual risk profile of the instrument and should not create unjustified level playing field issues at the expense of non-preferred covered bonds; (iii) they should be clearly separated from the covered bonds in order to correctly map the different risk profiles of the two classes of instruments and to avoid any market confusion or negative side effects on the covered bond market.

13 Article 52 of the UCITS Directive lays down minimum requirements for eligible bonds: (i) the issuer must be a credit institution registered in the EU and subject to special public prudential supervision; (ii) the law must determine which assets may be included in the cover pool; (iii) the cover pool must provide sufficient security to cover the claims of bondholders throughout the life of the bonds; (iv) the bondholders must have priority over claims to the cover pool in the event of bankruptcy of the issuer. Provided that the conditions are met, the UCITS funds may invest up to 25% of the assets in the bonds in question (like in covered bonds) instead of the standard 5%.

14 In accordance with Article 44(2)(b) of Directive 2014/59/EU (*the Bank Recovery and Resolution Directive*, BRRD), covered bonds compliant with UCITS are exempted from the bail-in. If SME ESNs are compatible with UCITS, such as traditional covered bonds, they should also fulfil the criteria necessary to be exempted them from the bail-in. Moreover, SME ESNs may be exempted from the bail-in pursuant to Article 44(2)(b) and in accordance with the preamble of BRRD 70 if they qualify as secured claims and the security covers 100% of the claim. Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 *establishing a framework for the recovery and resolution of credit institutions and investment firms* and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council Text with EEA relevance (*the Bank Recovery and Resolution Directive*, BRRD).

The EBA suggested that assuming a sufficiently high over-collateralisation, ESNs with a product standard similar to the covered bonds and additionally meeting the EMIR criteria (Commission Delegated Regulation (EU) 2016/2251) of the covered bonds, should be exempted from the requirement to establish initial and dynamic collateral margin, as is the case of covered bonds.

Provided that ESNs fulfil the requirements of eligible collateral for Eurosystem, they will be more resilient during a period of financial stress than securitisation instruments having static cover pools. The EBA recommended dynamic cover pools of ESNs with frequently performed stress tests, which would make them more attractive to investors.

2. Conditions for the development of the ESNs market

ESNs did not develop as initially expected. At the same time, new market solutions have emerged, such as the US loan guarantee scheme or the European EIF initiative, which could inspire the modification of this instrument.

2.1. Barriers to the development

Although ESNs are an interesting conceptual proposal, they have not yet gained sufficient market interest. It does not seem that possible further harmonization and cooperation of stakeholders would allow the market to be constructed in its current form. Financing of banking activities through ESNs would require their eligibility for repo transactions with central banks, which could pose a challenge in a situation of market stress. Current situation arising from the COVID-19 pandemic makes the requirements of IFRS 9 oblige banks to create provisions. The shift in credit assets to the next IFRS 9 classification ranges makes the deteriorating credit quality of commitment in the SME segment results in a deterioration of profitability of banks and weakens their capital. Significant pools of SME loans bring a risk of spiral in capital consumption and pose a challenge for their effective management. Risk transfer through, for example, securitisation will not be possible when these loans constitute a cover pool of ESNs.

When the idea of a new instrument for bank financing came into being, two alternative solutions were presented for ESNs:

- a financing instrument that maps the structure of covered bonds but based on a different asset class (depending on local regulations as a balance sheet or SPV instrument);
- static, amortised, dual recourse ABS SME, which is designed to relieve bank's capital.

The challenges faced in particular by smaller banks and weaker in terms of capital make financing SME assets a major challenge during market turbulence. On the other hand, support for SME is one of the pillars of the EU's CMU. The size and fluidity of the issues are key elements of success of traditional covered bonds. For this reason, the question arises of how to address all these challenges and create a new, secure and marketable EU financial instrument – ESNs?

2.2. American Credit Guarantee Programme

An interesting solution is the American Credit Guarantee Programme. The 7(a) Loan Program is run by the Small Business Administration (SBA), which is a U.S. government agency. A broad range of support for SME includes, among many, capital support, financing and consulting (*Small Business Administration...* 2021).

The loan guarantee program allows banks to provide financing to eligible SME, for which they pay a service fee and a guarantee fee. The criteria for support are not excessive. The amount does not exceed $5 million and the warranty period depends on its use. Depending on the amount of credit, the SBA guarantees between 75% and 85% of the bank's exposure, relieving its capital and providing adequate funding. Dedicated entities group loans guaranteed by the SBA from many banks and place them on the market in the form of bonds. These bonds have an unconditional guarantee of a government agency, which ensures the timeliness and full amount of payments, which means that they are treated in terms of risk on an equal footing with government bonds (*US Treasuries*). These bonds have a particular feature of the borrower's ability to prepay the financing. As they are often traded with a premium, investors, although they do not bear credit risk, bear the risk of prepayment. Nevertheless, the SBA's bonds are a desirable investment that banks can use in the process of liquidity management. The bank that granted the financing (*originating bank*) retains its residual capital participation, which enables underwriting and servicing.

2.3. European Investment Fund Initiative

The European Investment Fund (EIF) Initiative on SME financing has been launched in selected EU Member States[15]. The first guarantee instruments unlimited in amount were launched in Spain in 2015. As of August 2021, they also included SME

[15] The SME initiative is a joint financial instrument between the EC and the European Investment Bank Group (the European Investment Bank and the European Investment Fund), which aims to support the financing of the SME by providing partial coverage of the risk of the SME loan portfolio to funding institutions. In addition to the funds provided by Member States under the European Structural and Investment Funds (ESIF), the SME Initiative is co-financed by the EU from the project COSME and/or Horizon 2020 funds and by the EIB Group. Website of the European Investment Fund, SME Initiative, https://www.eif.org/what_we_do/guarantees/sme_initiative/index.htm (access 29.08.2021).

loans granted by banks operating in Bulgaria, Finland, Italy, Romania and Malta, and this initiative could be extended to further EU Member States. As part of the EIF initiative, banks identify SME loans granted as part of regular business that can receive 50% of risk coverage, after the guarantee fee has been paid. In this way, banks can free up capital, protect against loss and increase funding for SME. This initiative is managed by the EIF and the guarantee is provided by the EU and the European Investment Bank (the guarantor for the program implemented in Spain is the Kingdom of Spain) (*New Issue Rating Report* 2017).

The EIF initiative has some common features with covered bonds. It sets out eligibility criteria for loans and the retained capital participation of the financing bank and the mechanism for the sharing of loss with the guarantor ensure mutual interest and prevent the moral hazard of banks providing financing of the SME. As part of this initiative, an effective and standardized contract model has been drawn up and the eligibility criteria for SME loans include: credit quality, financing period, portfolio concentration and uniform definitions of concepts. Issues relating to state aid have also been addressed. The EIF, as an entity managing the initiative, retains effective supervision over the policies and procedures of the financing banks. It also provides a unified credit assessment of the reference cover pools of the contributing banks in order to maintain high quality of credit portfolios.

The EIF initiative, implemented in several countries, has mostly developed in Spain, but there has been a limited period of supplementation and is currently in a depreciation phase.

2.4. ESNs 2.0

In order for the next part of the European secured notes not to become a one-off project again, as is the case of its current version, it should address the following expectations (Fuchs, Bergman 2020, p. 4):

- clear and transparent guarantee structure similar to the EIB initiative, allowing for preferential risk weights and obtaining the highest rating;
- local regulations based on the EU Directive, which should ensure a high level of standardization and harmonization of security, a clear transfer mechanism and the division of roles and responsibilities;
- national pool structures supporting diversification of collaterals, allowing regular primary issues and ensuring high liquidity of the secondary market;
- flexible framework providing for the replenishment of the cover pool and the issuance of bullet bonds[16];
- preferential financing of eligible SME loans as an integral part of the CMU;

[16] The short-term and refinancing nature of the typical SME loans means that amortising bonds would be too low in issue volume from the point of view and according to the expectations of investors to keep a high level of LCR (early repayment would reduce the spreads).

- strong and sustainable commonality of interests of banks constituting the cover pool through the application of a dynamic guarantee premium[17];
- independent monitoring of required standards and transparency of emissions for investors.

ESFS 2.0, based on the European guarantee structure and addressing the above expectations, offers an opportunity to create an effective platform for financing SME in the EU. The establishment of a common European funding platform to pool the SME loans, while retaining the participation of risk finance banks (*skin in the game*), holding security in the form of EU guarantee, would provide a good basis for building a new class of assets with high-credit quality.

Regular and high emissions (*jumbo*) would allow the construction of an effective secondary market that would support the use of ESNs as high-quality liquid security that could be used by banks to manage the LCR requirements. The eligibility for the repo transaction with the central bank would increase the market acceptance of ESNs. Moreover, using securitisation techniques to transfer residual risks of EU-guaranteed instruments would allow investors to access the EU SME credit market as a whole or at least a very well-diversified SME risk of a given country.

In the investor environment, there is a growing support for portfolio allocation policy, which would allocate a certain pool of assets to management, for projects pursuing specific environmental, social and governance (ESG) objectives. This increases the growth potential of a new instrument. SME ESNs could, for example, provide exposure to a segment of the European economy, which traditionally has no easy access to finance, by obtaining a brand of social bonds. Like the development of an energy-efficient covered bonds market, SME ESNs could be grouped for economically disadvantaged areas or for socially-oriented borrowers to encourage investors who not only pay attention to the rate of return on investment but also to the ESG profile (*double bottom line approach*) of investment instruments. Taking into account the EC's actions toward a new green taxonomy[18], depending on the issue guarantee policy of the issuing bank, SME ESNs may become another sustainable financing instrument that would allow private capital to be included in the implementation of objectives of the ESG (*Financing a Sustainable European Economy* 2018). Complementing the eligibility criteria of the SME loans with ESG elements would allow these instruments to be covered by the European Green Deal label[19], providing them with additional support.

17 In order to eliminate moral hazard, the premium should measure the risk of the contributing bank instead of having a predetermined level. Retaining a risk on the part of the issuer would help to ensure high emission standards and efficiency of emissions.

18 The EU taxonomy is a system of a uniform classification of actions for sustainable economic development, which were defined by the regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 *on the establishment of a framework to facilitate sustainable investment*, and amending Regulation (EU) 2019/2088 (Text with EEA relevance) (Kwiatkowska 2020).

19 The European Green Deal is an action plan for a sustainable EU economy that it wants to achieve by transforming climate and environmental challenges into new opportunities in all policy areas, and by ensuring the transition to be fair and inclusive. Climate change and environmental degradation

Summary

The recovery of the post-pandemic European economy and in particular the SME segment, requires the creation of a new financing instrument and the stimulation of the development of the European capital market within the framework of the CMU project. SME ESNs should be formatted by creating a common, transparent framework at the level of the entire EU.

One of the achievements of the European Framework of Covered Bonds was a construction of a wide European market for which minimum requirements were agreed, contributing to an increased investor involvement. A catalogue of technical, regulatory requirements and product standards may also be created for ESNs. This way, these instruments could become another tool for a stable, long-term financing of banks, reducing the costs of financing SME, while contributing to the recovery of the post-pandemic European economy and to the increase of stability of the financial system.

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pose a threat to Europe and the rest of the world. To meet these challenges, the EU has announced the objectives of a new growth strategy to transform the Union into a modern, resource-efficient and competitive economy that will achieve a net zero greenhouse gas emissions in 2050, decoupling economic growth from resource use and in which no person or region will be "lagging behind". This initiative is also intended to support the exit from the COVID-19 pandemic. Financing of this project amounts to EUR 600 billion from the NextGenerationEU reconstruction plan and the 7-year budget of the EU. Website of the European Commission, European Green Deal, https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal_pl (access: 29.08.2021).

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